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Assessing Value for Money of the PPP

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A key objective of governments in implementing PPPs in infrastructure is to achieve value for money (VFM). *Value for money* means achieving the optimal combination of benefits and costs in delivering services users want. Many PPP programs require an assessment of whether a PPP is likely to offer better value for the public than traditional public procurement—often called *value for money analysis*.

A VFM analysis can be done for a specific PPP project, and at a program level, for projects with common characteristics. For example, the **United Kingdom Treasury's manual on assessing value for money** (UK 2011b) described how value for money should be assessed at both the program and project levels (that methodology was later considered biased and recalled by government).

VFM analysis typically involves a combination of qualitative and quantitative approaches. **Qualitative VFM analysis** consists of sense-checking the rationale for using a PPP. This involves asking whether a proposed project is of a type likely to be suitable for private financing, and whether the conditions are in place for the PPP to achieve value for money—for example, that the PPP has been structured well, and that competitive tension is expected during the bidding process. This often takes place at a relatively early stage of PPP development—as such, qualitative VFM analysis may constitute part of the PPP screening described in Screening for PPP Potential.

Some PPP programs also require **quantitative assessment** of value for money. This typically involves comparing the chosen PPP option against a *Public Sector Comparator* (or *PSC*)—that is, what the project costs would look like if delivered through traditional procurement. This comparison can be made in different ways. The most common is to compare the **fiscal cost** under the two options—comparing the risk-adjusted cost to government of procuring the same project through traditional procurement, to the expected cost to government of the PPP (pre-procurement) or the actual PPP bids (post-procurement). An alternative is to compare the two options with an **economic cost-benefit basis**—that is, to quantitatively weigh the expected benefits of a PPP over traditional procurement against its additional costs.

Value for money analysis—particularly using quantitative public sector comparator methodologies—has been widely debated. Some question the value and relevance of a PSC approach, which can appear to be more scientific than is the case, potentially misleading decision-makers; or conversely, may simply come too late in the process to be a genuine input to decision-making. A **World Bank report on Value for Money** (WB 2013a) analysis presents evidence on practices from several countries, and on trends regarding the scope of value for money analysis and the relative advantages of quantitative and qualitative approaches.

For more discussion on approaches to assessing value for money, and their relative advantages and disadvantages, see also:

- **Farquharson et al's** section on selecting projects (Farquharson et al. 2011, 41–43), which briefly describes value for money and cost benefit analysis, and considers the value of qualitative versus quantitative approaches.
- **Grimsey and Lewis's article on PPPs and Value for Money** (Grimsey and Lewis 2005, 347–351) includes a section on approaches to value for money describing examples of different countries' approaches.

- The **OECD's publication on PPPs** (OECD 2008a, 71–72), which also describes the range of methods used by different countries, on a *spectrum* of complexity, from simply relying on competition, to full cost-benefit analysis of different procurement options.
- The **PPIAF Toolkit for PPP in Roads and Highways** has a section on value for money and the PSC (WB 2009a), which describes the logic behind value for money analysis, and how the PSC is used.
- The **European PPP Expertise Centre (EPEC)** value for money assessment report (EPEC 2015) outlines and compares value for money assessment methodologies in several European countries.

The remainder of this section briefly describes and provides further resources for readers on qualitative and quantitative value for money assessment methodologies.

Qualitative value for money assessment

Qualitative VFM analysis involves sense-checking the rationale for using PPP as a delivery mechanism—that is, asking whether a proposed project is of a type likely to be suitable for private financing; as well as whether the conditions that are necessary to achieve value for money are in place, as described in **Farquharson et al**, (Farquharson et al. 2011, 42–43). This often takes place at a relatively early stage of PPP development—as such, qualitative VFM analysis may overlap with the PPP Screening process described in Screening for PPP Potential above—but may be repeated throughout the project development process.

Some jurisdictions have clearly-defined criteria for this analysis. For example:

- The **UK Treasury** has defined criteria for assessing suitability, and unsuitability, for a Private Finance Initiative (PFI)—the UK's availability payment PPP model. Suitability criteria include the long-term, predictable need for the service; the ability to allocate risk effectively—including through performance-related payments and ensuring sufficient private capital at risk; the likely ability of the private sector party to manage risk and take responsibility for delivery; presence of stable and adequate policy and institutions; and a competitive bidding market. *Unsuitability criteria* include projects that are either too small or too complicated; sectors where needs are likely to change or there is a risk of obsolescence (for example, PFI projects are no longer used in the ICT sector in the UK); or where the contracting authority is inadequately skilled to manage PPP (WB 2013a).
- In **France**, preliminary analysis of a PPP includes checking against several criteria under three categories: PPP relevance—for example, appropriateness of an integrated, whole-of-life approach to managing a project; commercial attractiveness; and the potential for optimal risk allocation (WB 2013a).
- In the **Commonwealth of Virginia, United States**, assessment of a potential PPP at high level and detailed screening stages also considers proposed road projects against specific criteria to determine if the project is delivered under the Public-Private Transportation Act (PPTA)—that is, as a PPP. These criteria include whether a project is sufficiently complex to benefit from private sector innovation; whether a PPP can achieve appropriate risk transfer; and the degree of stakeholder support. The extent to which a project can generate revenues from tolls is also taken into consideration when assessing possible PPP structures (WB 2013a).
- The **Caribbean PPP Toolkit** (Caribbean 2017, Module 4, Section 8) presents **Jamaica**'s methodology for assessing value for money, and other globally-relevant guidance.

The **EPEC Guide to Guidance** also includes a list of key conditions that should be met to have a higher probability of achieving value for money (EPEC 2011b, Chapter 1.2.4).

Public Sector Comparator—comparing fiscal cost

The most common quantitative tool for value for money assessment of a PPP project is derived from the approach originally used in the United Kingdom's PFI program in the early 1990s as described in **Leigland**

and Shugart's Gridlines article on the PSC (Leigland and Shugart 2006). It involves comparing the fiscal cost of a PPP delivery option with that of a conventional public delivery option—not a single conventional option, but a range of infrastructure options as noted in the **2011 Treasury Guidance on Valuing Infrastructure Spend** (UK 2015a). **NAO evidence presented in the House of Commons 2014 report** (UK 2014a) discusses several shortcomings in the identification of PSCs.

The focus of the Fiscal Cost approach to value for money analysis is the construction of a PSC—the cost to government of implementing the project through traditional public procurement. Calculating the PSC can be complicated, as several adjustments are needed to ensure a fair comparison. How the Public Sector Comparator is calculated, highlights some methodological debates.

This type of PSC can be used at two stages of the procurement process, as described in the **OECD book's chapter on the economics of PPPs** (OECD 2008a, 71–72). These are:

- **Before the bidding process**—the PSC can be compared with a shadow or reference PPP, or market comparator—a model of the expected cost of the project under the PPP option. This can help identify whether the PPP can be expected to provide value for money, before deciding to go ahead with detailed preparation and procurement. The reference PPP model would be the same as the financial model described in Assessing Commercial Viability.
- **During the bidding process**—the PSC can also be compared with actual PPP bids received, to assess whether the bids provide value for money. This approach is used in **Australia**, and is described in a PSC Technical Note (AU 2016a).

Despite the appealing logic of the concept, there have been many criticisms of the usefulness of the PSC and fiscal cost comparison approach in countries where it has been used frequently, such as the United Kingdom and Australia. A **United Kingdom House of Lords' review of the PPP program** (NAO 2013a), for example, argued that shortage of relevant data and methodological issues limit the value of the PSC. The government's response to the review agrees that the PSC provides only a partial picture, and highlights that its use is balanced with qualitative analysis, as described above.

Leigland and Shugart's Gridlines article on the PSC (Leigland and Shugart 2006, 2–3) summarizes these criticisms, which include the inevitable inaccuracy of estimates over a long-term project, lack of consensus on methodology, and so the possibility of manipulation to reach the desired conclusion. **Grimsey and Lewis** (Grimsey and Lewis 2005, 362–371) describe some of these criticisms in more detail. Given these challenges, **Leigland and Shugart's Gridlines article** (Leigland and Shugart 2006, 3–4) also discusses whether and how the PSC approach could make sense in a developing country context.

How the Public Sector Comparator is calculated

Calculating a PSC can be complex. The starting point is typically the best estimate of the capital cost and lifetime operations and maintenance cost of implementing the project under public procurement. This is typically adjusted, to enable a fair comparison between the PSC and the PPP. The **Infrastructure Australia guidance note on PSC** (AU 2011b, Section 2.3) describes two types of adjustment:

- **Risk adjustments**—one of the main differences between traditional procurement and the PPP approach is that the PPP transfers more risks to the private party. The return on investment expected by the private party will consider these transferred risks. This means that to make a fair comparison, the PSC should also consider the cost of these risks.
- **‘Competitive neutrality’ adjustments**—a public sector project or enterprise may have cost advantages or disadvantages compared to a private company, which creates costs or benefits to the

government that are not normally considered when considering the cost of a traditionally procured project. For example, the tax liabilities under the two options may be different. These differences should be corrected for in calculating the PSC.

There are also differences in the timing of payments between the PPP option—where payments are often spread over time—and traditional procurement, where the government must meet construction costs upfront. The streams of payments are usually converted into **net present values**, to give a single value for comparison. This requires defining the appropriate discount rate to apply to future cash flows in both the PPP and PSC models.

The following provide further descriptions and examples of how the PSC is used and calculated in different countries:

- The **Treasury of the United Kingdom's detailed guidance** for quantitative PSC assessment was recalled in 2013, and guidance on qualitative assessment was developed.
- **South Africa's PPP Manual's** module on the PPP Feasibility Study includes a detailed description of how to calculate and use the PSC (ZA 2004a, Module 4, 17–49).

Methodological differences and challenges

Although the PSC has been widely used, the methodology differs between countries, and there is ongoing debate on several methodological points. For example, **Shugart's article on the PSC** (Shugart 2006) highlights two related issues: which is the appropriate discount rate to use when calculating present values, and how the cost of risk should be considered. **Grimsey and Lewis** (Grimsey and Lewis 2004) and **Gray, Hall and Pollard** (Gray et al. 2010) both focus on the choice of discount rate, and its relationship with risk allocation under PPP and traditional procurement. In **IFC's report on lessons learned** (IFC 2010, 7-13), José Luis Flores presents a concrete case of "value for money" assessment.

Some countries in Latin America, such as Colombia and Peru, have developed guidelines for implementing the PSC methodology. However, due to lack of capacity and or trustworthy information to implement such a complex methodology, none of these countries have implemented the full methodology in practice.

The **World Bank report on Value for Money assessment practices** (WB 2013a, 23–28) reviews methodological evolution and practices in several governments with significant PPP experience, including the United Kingdom, France, India, Chile, the U.S. state of Virginia, and British Columbia, Canada.

Economic cost-benefit comparison of PPP and public procurement

One of the criticisms sometimes leveled at the PSC is that it focuses solely on the financial cost to government of PPP or traditional procurement. A more comprehensive approach would also consider the differences in expected benefits, and compare the net economic benefit under PPP or under public procurement. On the other hand, as **Grimsey and Lewis** note (Grimsey and Lewis 2004, 353), this adds further complexity to the value for money analysis over the PSC approach, and could risk making the results even more subjective.

For example, the **EPEC's note on non-financial benefits of PPP** (EPEC 2011c) suggests how some of the benefits of PPP—as described in Infrastructure Challenges and How PPPs Can Help—could be quantified, and added to a more typical PSC analysis.

Few countries have introduced this kind of analysis in practice. **New Zealand**'s new PPP program is an exception. Cost-benefit analysis is the main tool for assessing procurement options. **New Zealand's PPP guidance material** (NZ 2016, 6–12) asks practitioners to identify the possible benefits of PPP over traditional public procurement and where possible to assign dollar values to each benefit.

In many developing countries' PPP programs, the aim is not just to reduce cost, but to transform service delivery. For example, governments hope that roads will be better maintained, thus delivering additional trade and economic benefits. These changes in service levels and quality cannot be captured by comparing fiscal costs of PPP and public procurement. Where these expected benefits are deemed important, and quantitative value for money analysis is desired, economic cost-benefit analysis may be the better approach.

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Additional Resources

- Procurement Processes and Bidding Documents
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